Supreme Court of the United States

October Term, 1938

No. 168

BRONX COUNTY TRUST COMPANY, as ...
Fordham National Bank in New York,

v.

against

A. BRUCE BIELASKI and KEYES WINTER, ...
Trustees in Bankruptcy of Benedict Metal ...

PETITION FOR WRIT OF CERTIORARI ...
UNITED STATES CIRCUIT COURT OF ...
FOR THE SECOND CIRCUIT, AND ...
IN SUPPORT THEREOF

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Supreme Court of the United States

OCTOBER TERM, 1936

No. .....

BRONX COUNTY TRUST COMPANY, as successor to Fordham National Bank in New York,

Petitioner,

against

A. BRUCE BIELASKI and KEYES WINTER, as surviving Trustees in Bankruptcy of Benedict Metal Works, Inc.,

Appellees.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of BRONX COUNTY TRUST COMPANY, by its counsel, Bertram Boardman, respectfully shows:

Summary Statement of the Matter Involved.

The questions presented in this case are:

1. Whether the criminal activities of the treasurer of a corporation may be imputed to the corporation itself not only in the absence of evidence that the other officers and

directors authorized, or had knowledge of such activities, but in the face of uncontradicted testimony that neither such officers or directors, nor any of the employees of the corporation, had any knowledge of the same whatsoever.

2. Whether thefts and forgeries committed by the treasurer of the corporation for his own purposes were sufficient evidence of its insolvency and of an intent by such corporation (the bankrupt) to prefer the defendant bank.

3. Whether under the undisputed and uncontradicted evidence in the case there was any depletion of the bankrupt's estate.

4. Whether the plaintiff trustees in bankruptcy, ostensibly acting for all of the creditors of the bankrupt, may, in this action, recover moneys stolen by the treasurer of the bankrupt corporation from the Nassau National Bank, which moneys were traced directly into the defendant bank. The moneys having been obtained from the Nassau National Bank by means of forgeries committed by the bankrupt's treasurer for his own purposes, the transactions by which such moneys were obtained could have been set aside at the instance of the Nassau National Bank and such moneys reclaimed. For reasons unknown, this procedure was not adopted, but, instead, the plaintiff trustees, appointed at the instance of the Nassau National Bank, seek recovery in this action. The moneys in question never having become the property of the bankrupt corporation, but having been merely passed through the bank accounts of the said corporation, as the undisputed evidence clearly shows, such moneys never became part of the bankrupt's estate and there consequently was no depletion of such estate by the payments in question.

Reasons Relied on for Granting Petition.

For reasons more fully set forth below, your petitioner submits that:

1. The learned District Judge and the Circuit Court of Appeals erred as a matter of law in deciding upon uncontradicted evidence that a preference had been committed under the Stock Corporation Law of the State of New York and under the Bankruptcy Act.

2. The decision below is contrary to any decision of the Supreme Court of the United States or of any other court which we have been able to find, or to which reference has been made by the plaintiffs.

3. The finding that the preference is in violation of the Bankruptcy Act is not only contrary to law but, if the decision below is sustained, it would add greatly to the perils of banking, in that every transaction by a bank with a corporate customer would be subject to the hazard of being set aside at some later date on a mere showing that one of the officers of such corporation (later become bankrupt) had been guilty of thefts and forgeries for his own purposes.

4. The result reached below is so far at variance with the law as established by the decisions of the Supreme Court of the United States that it should not be permitted to stand.

WHEREFORE, it is respectfully submitted that the petition for writ of certiorari should be granted.

BERTRAM BOARDMAN,
Attorney for Petitioner.

BRIEF IN SUPPORT OF PETITION.

Opinion Below.

The opinion of the District Judge is not reported. It appears in the record at pages 408 to 422. The Circuit Court of Appeals affirmed, without opinion.

Jurisdiction.

This Court has jurisdiction to review the judgments below under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 [U. S. C., Title 28, Sec. 347(a)]. The date of the judgment sought to be reversed is June 4, 1936.

Statutes Involved.

Section 60(b) of the Bankruptcy Act provides, in part, as follows:

> "If a bankrupt shall * * * have made a transfer of any of his property, and if, at the time of the transfer * * * and being within four months before the filing of the petition in bankruptcy or after the filing thereof and before the adjudication, the bankrupt be insolvent and the * * * transfer then operate as a preference, and the person receiving it * * * shall then have reasonable cause to believe that the * * * transfer would effect a preference, it shall be voidable by the trustee and he may recover the property or its value from such person."

Section 15 of the Stock Corporation Law of the State of New York (Consolidated Laws, Chap. 59, Laws of 1923), as it existed in 1928 (same has been since amended), reads, in part, as follows:

> "PROHIBITED TRANSFERS TO OFFICERS OR STOCKHOLDERS. No corporation which shall have refused

to pay any of its notes or other obligations, when due, in lawful money of the United States, nor any of its officers or directors, shall transfer any of its property to any of its officers, directors or stockholders, directly or indirectly, for the payment of any debt, or upon any other consideration than the full value of the property paid in cash. No conveyance, assignment or transfer of any property of any such corporation by it or by any officer, director or stockholder thereof, nor any payment made, judgment suffered, lien created or security given by it or by any officer, director or stockholder when the corporation is insolvent or its insolvency is imminent, with the intent of giving a preference to any particular creditor over other creditors of the corporation, shall be valid, * * *."

Statement of Case.

(Page references are to the Transcript of Record.)

This action was brought to recover from the defendant, Fordham National Bank (since merged into the Bronx County Trust Company), the amount of three loans which had been made by the bank ostensibly to the Benedict Metal Works, Inc., the bankrupt corporation. The loans were made in January and March of 1928 and were repaid over a period extending from May 11, 1928, to June 20, 1928.

One John J. Sparler was the treasurer and a director and stockholder of the Benedict Metal Works; Bernard Benedict, the founder and organizer of the business, was its president and also a stockholder and director (pp. 68, 359).

At the time of the making of the loans aforesaid, the said Sparler had been and was, engaged in the commission of a series of forgeries and thefts whereby he obtained moneys from several of the large banks in the City of New York, by means of the forgery of trade acceptances and other negotiable paper and by the endorsement on such paper of the name of the Benedict Metal Works, Inc. This method he followed in obtaining from the Fordham Bank some $27,500, the amount in suit (p. 152).

It is not contended by the plaintiffs that the bank had any knowledge whatsoever of the spurious character of the paper discounted by it, nor was it contended on the trial that any other officer of the Benedict Metal Works knew at that time or at any other time until after the bankruptcy that Sparler had been engaged in these criminal activities, and indeed the record shows that the accountant and bookkeeper of the corporation were likewise in complete ignorance of the situation (pp. 61, 139, 185, 242).

Sparler was able to carry on this deception of his associates in business and of the employees of the bankrupt corporation by means of what was known as the "John J. Sparler Special Account" which was carried on the books of the corporation and wherein were credited and debited the moneys which Sparler obtained by means of his forgeries and thefts and those which he paid out from time to time to make good prior thefts and, it may be assumed, to avoid detection (p. 56; Plffs.' Ex. 12, p. 382; see also, pp. 69, 70, 135, 192).

It should be noted in passing that in addition to the forged paper represented by the three items in suit, the bank also loaned to the Benedict Metal Works on its own direct paper, that is, upon paper executed by itself as maker, payable to the bank the sum of $32,500. This direct paper was renewed and extended from time to time (and in the very period during which the alleged preferential payments were being made), and as a matter of fact at the time of the adjudication in bankruptcy, there remained due and unpaid to the defendant bank the sum representing the discount of this paper (pp. 98, 99; Plffs.' Ex. 1, p. 376).

The three payments which are the subject of this action were made by Sparler to the defendant bank with funds which he stole from the Nassau National Bank by means of the use of forged commercial paper. The proceeds of these forgeries were passed through the account of the Benedict Metal Works in the Nassau National Bank and immediately transferred and paid over to the Fordham National Bank. The transactions were characterized as "wash transactions" (p. 248); the moneys thus obtained by Sparler "went in and went out" of the Benedict account (pp. 306, 307).

Sparler stole from the Nassau National Bank in order to pay the Fordham National Bank or, in other words, as the learned counsel for the plaintiffs aptly stated, at the trial, Sparler "robbed Peter to pay Paul" (p. 252).

It thus appears that there was no depletion of any assets of the bankrupt corporation which rightfully belonged to its creditors.

Prior to the payments to the bank, Sparler and one Friedman had paid off obligations of the corporation totalling $215,000, for which an increase of stock of the corporation was voted thereby reducing its liabilities to creditors to that extent (pp. 75, 76, 77, 80). (This increase of capital stock sufficiently appears by Plffs.' Ex. 7, p. 380; Plffs.' Ex. 12, p. 382; Plffs.' Ex. 19, p. 385; Deft's Ex. F, pp. 402 *et seq.*).

In the meantime the business of the Benedict Metal Works was continuing right along; production increased, additions were made to its plant and machinery, salary and payroll were stepped up and all of the other factors indicated a continuance in business and demonstrated that insolvency and liquidation were never contemplated at the times of the alleged preferential payments (pp. 64-66, 67, 128, 129, 193, 194, 215, 216, 244, 285, 326).

The undisputed evidence shows that none of the officials of the defendant bank ever pressed Sparler for payment of the three items in question (p. 240), and as a matter of fact Sparler took his own good time in making the payments; the first request being at the end of April or early in May, the first payment being on May 11th and the last on June 20th of 1928 (pp. 214, 240).

Initial inquiry with respect to the paper discounted at the defendant bank was not engendered by anything that had occurred; but arose because of the establishment by the bank at that time of a system of checking which was then being installed (p. 146). Sparler himself was a director of the bank and so continued until some weeks after the transactions in question (pp. 34, 35). He was also the owner of record of 100 shares of stock of the bank and had given to the bank financial statements both of his company and him-

self showing considerable assets over liabilities (Deft.'s Exs. C and D, p. 400; Deft.'s Ex. E, p. 401). He gave a plausible explanation of the matter which was believed by the bank's officials, as is amply evidenced by the record (pp. 152, 154-155) as well as by their course of conduct then and at subsequent times.

There is here no dispute in the evidence. A pure question of law is involved. Do the facts constitute a voidable preference under the Bankruptcy Act and the New York Stock Corporation Law?

Specification of Errors.

The District Court erred as a matter of law in holding:

1. That voidable preferential payments have been established under Section 60 (b) of the Bankruptcy Act and under Section 15 of the Stock Corporation Law of the State of New York;

2. That the alleged preferential payments depleted the assets of the bankrupt which would otherwise have been available to its general creditors;

3. That by the undisputed evidence the defendant had knowledge or reasonable cause to believe that a preference was intended;

4. That there was an intent by the bankrupt corporation to prefer the defendant;

5. That the Benedict Metal Works was insolvent or that its insolvency was imminent at the time of the alleged preferential payments;

6. That the defendant bank was a creditor of the corporation with respect to the payments in question;

7. The Circuit Court of Appeals erred in affirming the judgment of the District Court.

ARGUMENT.

POINT I.

The alleged preferential payments worked no depletion in the assets of the Benedict Metal Works which would otherwise have been available to its general creditors.

The undisputed testimony shows that the proceeds of Sparler's transactions were never carried on the books of the Benedict Metal Works as a liability of the bankrupt to the bank, all of these transactions being entered in the so-called "John J. Sparler Special Account." Neither the bookkeeper nor the accountant for the company ever knew of any liability by reason thereof.

The undisputed evidence is to the effect that by means of forgeries Sparler obtained moneys at one bank for the purpose of repaying to some other bank moneys which he had similarly obtained by means of forged paper and of forged endorsements of the name of Benedict Metal Works.

The evidence further shows, not only by the testimony of Sparler himself, but by an employee of the Nassau National Bank called by the plaintiffs, and by the exhibits in evidence, that Sparler "switched" the moneys that he obtained from the Nassau National Bank into the Fordham National Bank (pp. 256-259; Plffs.' Ex. 2, p. 377; Deft's. Exs. A and B, pp. 399-400; see also the stipulation on the record, p. 107).

The evidence is uncontradicted that the moneys so obtained, which were used in connection with the alleged preferential payments, never became the property of the Benedict Metal Works, never formed any part of the assets of that company, and, hence, the estate of the bankrupt was never depleted thereby.

The petitioner contends that as to these moneys, which were directly traced from the Nassau National Bank to the Fordham National Bank, the bank account of the Benedict Metal Works was used as a mere conduit by Sparler for his own uses and purposes.

There is no question but that had this money been found in the possession of the bankrupt or of the plaintiff-trustees, the Nassau National Bank could have set aside the transaction for fraud and reclaimed the same as its property (*Cunningham* v. *Brown,* 265 U. S. 1).

The petitioner contends that while the Nassau National Bank may have some cause of action in its favor by reason of the transactions in question, nevertheless these moneys cannot be recovered in this action at the suit of the trustees for the creditors.

It is well settled that unless an insolvent debtor so disposes of his property for the benefit of a creditor that the estate of the debtor which would otherwise be available to meet the claims of all creditors is diminished, a creditor cannot be charged with receiving a preference (*Western Tie & Lumber Co.* v. *Brown,* 196 U. S. 502, 509; *National Bank of Newport* v. *National Herkimer County Bank,* 225 U. S. 178; *New York County National Bank* v. *Massey,* 192 U. S. 138, 147).

In *Credit Alliance Corp.* v. *Sheridan Theatre Co.,* 241 N. Y. 216, the defendant's president, by means of forged paper, obtained a loan ostensibly to the defendant corporation, and deposited the proceeds of this loan in its bank account. Thereafter he withdrew the same by check. The Court of Appeals held that under the circumstances his acts were wholly unauthorized, he was not the defendant's agent and his knowledge could not be imputed to it.

In the case of *Hoberg* v. *Sofranscy,* 248 N. Y. 141, it appeared that a dishonest treasurer of what was an honest corporation (for all that the record showed), without its knowledge, utilized its name "in order to promote his personal rascalities." He did this by means of endorsements of the corporate name and his signature as treasurer. There, as here, there was nothing to indicate that he was authorized to endorse for the purposes which he did. The Court there held that the corporation was not answerable for the acts of its treasurer.

The defendant at bar sought to show that Sparler was not authorized to engage in his nefarious transactions. The evidence was excluded by the learned Trial Court (pp. 185, 186).

POINT II.

There is no proof of any intent of the Benedict Metal Works to prefer the defendant or that the defendant bank had any cause to believe a preference was effected by the payments in question.

Under the provisions of Section 15 of the Stock Corporation Law of the State of New York, as the same existed in 1928, it was not necessary that the payee or transferee of moneys by a corporation have knowledge of an intent to prefer if the corporation was insolvent or its insolvency imminent (*Dalziel* v. *Rosenfeld*, 265 N. Y. 76). This harsh rule was modified by the Legislature in 1929, but even under the old rule plaintiffs failed to prove any cause of action under that section of the law or under Section 60(b) of the Bankruptcy Act.

If, as the record shows, none of the officers, directors or stockholders of the Benedict other than Sparler were aware of the latter's criminal activities, or knew of the payments in question until long after they were made, it is inconceivable how there could have been a preference by the corporation by the payments in question.

As a matter of fact, each payment was "an extraordinary payment dictated by the personal necessities of Sparler more than by any other consideration" (per Patterson, *D. J.*, in *Bielaski* v. *National City Bank*, 58 Fed. (2d) 657).

The decision in that case was affirmed by the Circuit Court of Appeals, 68 Fed. (2d) 723, but attention should be directed to the fact that the question of insolvency, as well as intent to prefer, was not there placed in issue as it was in the case at bar, Chase, *C. J.*, saying:

> "That the bankrupt (Benedict Metal Works) was insolvent when the notes were paid and intended to prefer the defendant over other creditors was not disputed."

Much stress was laid by the plaintiffs in the Circuit Court of Appeals below upon the decision in the foregoing case, but it should be borne in mind that the issues there were far different than those which were litigated at bar, particularly since the payments here at issue were made at different times and after the Benedict had been reorganized by the capitalization of $215,000 of its obligations into stock.

In *Bielaski* v. *National City Bank, supra,* it was assumed both by the litigants and by the learned Judges as well, that Sparler's acts were imputable to the Benedict Metal Works and that when he made the payment to that bank his purpose and intent, as well as his knowledge, were those of the corporation.

Here we have consistently contended to the contrary, but the learned Trial Judge below ignored the contention and speaks in his opinion as though Sparler's criminal activities were those of the corporation's, when there is not the slightest evidence to sustain any such thesis.

Furthermore, in that case the action of the bank clearly indicated guilty knowledge—or so it could have been found. Thus the discovery by the bank of Sparler's wrongdoing was followed by peremptory demands for immediate payment. That payment was accompanied by the burning of the forged paper which Sparler had given and both he and the Benedict were rushed out of the bank and the account closed.

In the case at bar, all these, or similar, circumstances are lacking. Here there never was knowledge by the bank or any cause whatever to believe that Sparler was a thief until long after the bankruptcy, when his criminalities were exposed for the first time. Here there was no peremptory demand for payment, but merely a request that the paper be taken out of the bank. The payments were spread over a period of six weeks, at Sparler's own convenience and in his own good time and without further discussion.

The opinion of the District Judge below also states that the payments made by Sparler were made to enable him "to keep a step ahead of detection" (p. 410).

Also important is that there is not the slightest evidence that the Benedict was winding up its affairs or contemplating liquidation or bankruptcy at the time. These were necessary elements which the plaintiffs failed to prove (*Cardozo* v. *Brooklyn Trust Co.*, 228 Fed. 333).

In *McNaboe* v. *Columbian Mfg. Co.*, 153 Fed. 967 (the Circuit Court of Appeals affirming on the opinion of Hough, *D. J.*), the president of the bankrupt took moneys and passed the same through the bankrupt's bank account and therewith made restitution of moneys that he had stolen from another, "by such repayment probably saving himself from criminal prosecution," but the transaction, including payment and repayment, being something of which the defendant had no knowledge and "as to which the law expressly repudiates any imputation to the corporation of a dishonest director's knowledge," recovery was denied.

Then there is the renewal by the bank of the direct paper of the Benedict to the extent of $32,500 and the fact that this sum remained unpaid at the time of the bankruptcy. If the bank were anxious for payment, or knew or had reasonable cause to believe that the Benedict was insolvent or that its insolvency was imminent, it is inconceivable that some effort would not have been made to obtain payment of this larger sum.

The undisputed evidence is that no pressure was put upon Sparler and that the bank had no knowledge of Sparler's activities, and he continued as one of its directors long after the making of the alleged payments.

The payments in question extended over a period of nearly two months from the time that the bank first requested Sparler to liquidate the obligations in question. Thus there was no evidence of either haste or anxiety on the part of the bank.

All of the facts negative any knowledge or intent on the part of the bank and the finding of the Trial Court of such knowledge or intent is erroneous and without any evidence whatsoever to support it.

In *Grant* v. *The First National Bank*, 97 U. S. 80, Justice Bradley held that even though the officers of a bank had reason to be suspicious, that fact fell short of establishing that they had reasonable cause to believe that their customer was insolvent.

In *Everett* v. *Warfield Mining Co.*, 37 Fed. (2d) 328, it was said that a creditor may feel anxious about his claim and have a strong desire to secure it or have it paid, and yet such circumstances do not bring the transaction within the prohibition of the statute.

In *Grandison* v. *Robertson*, 220 Fed. 985, it was said:

> "The bankruptcy act does not take away from a banker the right to transact business with his customer in the ordinary way. He may take renewal notes in extension of credit and receive partial payment of his debt, and has the right during the continuance of their relations to presume that his debtor is solvent and carrying on business in the usual way; and if it turns out that the debtor was insolvent the creditor may receive payment without incurring the liability of having to restore such payment when bankruptcy intervenes."

None of the familiar badges of fraud or of guilty knowledge are present in the case at bar. The record discloses the ordinary situation existing between bank and customer. Only after the bankruptcy were Sparler's activities discovered. Knowledge gained at that time cannot be used to establish a situation which existed prior thereto.

If this case is to stand, it establishes a precedent which will make it hazardous for a bank to deal with a corporation, for transactions entered into in good faith may be set aside upon a mere showing that an officer of the customer was a thief. Such is not, and should not be, the law.

POINT III.

Plaintiffs wholly failed to prove insolvency of the Benedict Metal Works or that its insolvency was imminent at the time of the alleged preferential payments.

The learned Court erred in admitting in evidence financial statements purporting to show the condition of the bankrupt on March 31st, June 30th and August 24th, 1928 (Plffs.' Exs. 26, 27, 28, pp. 392-396). Both the accountants who prepared these exhibits and the Trial Judge disregarded the capital increase of $215,000, although the books of the bankrupt corporation clearly reflected this transaction.

The learned Trial Court refused to permit testimony as to the agreement between Sparler and one Friedman relating to this stock increase (pp. 205-207). It is submitted that this ruling is error and related to a material matter. The plaintiffs' accountant conceded that by this refinancing the Benedict had a surplus of assets over liabilities of $106,000 (pp. 323, 327, 333).

In view of the record and exhibits, which undisputably show that the authorized capital of the corporation had been increased by appropriate resolution of the stockholders, the filing of the requisite certificate of increase with the Secretary of State and the payment of the tax and filing fees thereon, it must be held as a matter of law that a valid stock increase had been consummated and the learned Trial Judge fell into error in holding to the contrary.

The plaintiffs did not sustain the burden which was cast upon them of proving a single one of the elements necessary in order to establish the cause of action alleged in the complaint.

Dated, July 7, 1936.

Respectfully submitted,

BERTRAM BOARDMAN,
Attorney for Petitioner.